

Message Text

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ACTION EB-11

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P R 191821Z JUL 74
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INFO DISTENGR RIYADH SAUDI ARABIA
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AMEMBASSY THE HAGUE
AMEMBASSY LONDON
AMCONSUL MILAN
AMCONSUL NAPLES
AMEMBASSY OTTAWA
USMISSION OECD PARIS
AMEMBASSY PARIS
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TREASURY DEPARTMENT WASHDC PRIORITY

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PASS FRB

E.O. 11652: N/A
TAGS: EFIN, IT
SUBJECT: ITALIAN EXCHANGE MARKET DEVELOPMENTS

REF: ROME 9946 DATED JULY 18, 1974

1. SUMMARY. ALTHOUGH BANK OF ITALY CONTINUES TO HAVE NET RECEIPTS
FROM EXCHANGE MARKET INTERVENTION, THIS HAS ONLY BEEN MADE POSS-
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IBLE BY LARGE SHORT-TERM BANK CAPITAL INFLOWS. OVERALL BALANCE

OF PAYMENTS DEFICIT IN JUNE WAS ABOUT \$583 MILLION, AND CUMULATIVE DEFICIT FOR FIRST SIX MONTHS WAS \$6.7 BILLION. NEW COMPENSATORY EUROMARKET BORROWINGS ARE BEING HELD UP BY UNWILLINGNESS OF EUROBANKS TO GRANT FURTHER REVOLVING LOANS, GIVEN CURRENT EUROMARKET CONDITIONS. NO DECISION MADE AS YET ON FURTHER EXTENSION OF MATURITY OF \$1.9 BILLION EC SHORT-TERM CREDIT TO ITALY.
END SUMMARY.

2. SINCE MID-JUNE, BOI HAS BEEN ABLE TO MAKE NET PURCHASES OF FOREIGN CURRENCY IN EXCHANGE MARKET. PRELIMINARY FIGURES FOR BALANCE OF PAYMENTS MONETARY MOVEMENTS THROUGH END-JUNE INDICATE THAT BOI GOLD AND CONVERTIBLE CURRENCY HOLDINGS INCREASED IN LAST HALF OF MONTH BY \$169 MILLION. HOWEVER, FOR ENTIRE MONTH THERE WAS DECLINE OF \$190 MILLION DUE TO LOSSES IN FIRST HALF OF MONTH. BOI NET PURCHASES OF FOREIGN EXCHANGE HAVE CONTINUED IN JULY TO DATE (SEE REFTEL) BUT CHANGES IN POSITION OF COMMERCIAL BANKS DURING JULY NOT YET KNOWN.

3. IN MONTH OF JUNE, COMMERCIAL BANKS' NET FOREIGN LIABILITIES INCREASED BY \$437 MILLION; I.E., BANKS INCREASED THEIR NET FOREIGN BORROWINGS BY THIS AMOUNT. ALL OF RISE OCCURRED IN LAST HALF OF MONTH WHEN THERE WAS INCREASE IN NET LIABILITIES OF \$536 MILLION. (IN FIRST HALF OF MONTH BANKS HAD REDUCED NET FOREIGN LIABILITIES BY \$99 MILLION.) HEAD OF BOI EXCHANGE OPERATIONS ERCOLANI THOUGHT THAT LARGE SHORT-TERM INFLOW THROUGH COMMERCIAL BANKS REPRESENTED BORROWING BY BANK'S CLIENTS, STIMULATED BY RELATIVELY LOWER INTEREST RATES ABROAD THAN IN ITALY AND BY REDUCED EXCHANGE RISK FOLLOWING STRENGTHENING OF LIRE IN EXCHANGE MARKETS SINCE MID-JUNE. HE ATTRIBUTED RECENT DECLINE INTER-BANK INTEREST RATES FROM ABOUT 19 1/2 PERCENT PER YEAR TO ABOUT 17 1/2 PERCENT TO THIS CAPITAL INFLOW AND TO LARGE SEASONAL PAYMENTS BY ITALIAN TREASURY. ERCOLANI TOLD TREAS ATT ON VERY CONFIDENTIAL BASIS THAT BOI IS CONSIDERING TAKING SOME MEASURE TO LIMIT INFLOW OF SHORT-TERM BANK FUNDS FOR FEAR THAT IT WILL UNDERCUT TIGHT CREDIT POLICY. ALSO,, SHORT-TERM CREDIT INFLOW TENDS TO HIDE CONTINUED LARGE DEFICITS, BOTH ON TRADE AND ON BASIC BALANCE.

4. RECORDED OVERALL BALANCE OF PAYMENTS DEFICIT IN JUNE WAS \$583 MILLION. THERE WERE NO COMPENSATORY EUROMARKET LOAN RECEIPTS LIMITED OFFICIAL USE

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DURING THAT MONTH, SO THAT ADJUSTED DEFICIT WAS ALSO \$583 MILLION. ALTHOUGH GLOBAL DEFICIT REMAINS VERY LARGE, IT IS SIGNIFICANTLY LESS THAN ADJUSTED DEFICITS (I.E., INCLUDING COMPENSATORY EUROMARKET BORROWINGS) OF MORE THAN \$1 BILLION EACH IN PREVIOUS FOUR MONTHS--FEBRUARY THROUGH MAY--AND IS LOWEST MONTHLY DEFICIT THIS YEAR. ALTHOUGH TRADE DATA ARE NOT AVAILABLE BEYOND MAY (CUMULATIVE DEFICIT OF OVER \$5 BILLION), THERE IS SOME REASON TO BELIEVE THAT TRADE DEFICIT MAY BE DECLINING SOMEWHAT. ALSO,

TOURIST RECEIPTS ARE SEASONALLY HIGH AT THIS TIME OF YEAR AND CREDIT SQUEEZE IS EVIDENTLY FORCING SOME RETURN FLOW OF CAPITAL.

5. ERCOLANI SAID THAT NEGOTIATION OF PROPOSED EUROMARKET STATE RAILWAYS LOAN AND OTHER PENDING EUROMARKET LOANS HAD BEEN IMPEDED BY GENERAL UNWILLINGNESS OF EUROBANKS TO EXTEND MEDIUM-TERM CREDIT IN FORM OF REVOLVING LOANS. THIS SEEMS TO BE DUE TO GENERAL EUROMARKET CONDITIONS, RATHER THAN TO SPECIFIC ITALIAN SITUATION.

6. BOI VICE DIRECTOR GENERAL OSSOLA TOLD TREAS ATT ON JULY 19 THAT NO DECISION HAS BEEN MADE AS YET ON EXTENDING MATURITY OF \$1.9 BILLION EC SHORT-TERM CREDIT. THEORETICALLY, CREDIT CANNOT BE ROLLED OVER FOR MORE THAN ONE THREE-MONTH PERIOD; I.E., TO SEPTEMBER 18, 1974, AFTER WHICH EC MEDIUM-TERM CREDIT MECHANISM SHOULD BE EMPLOYED. OSSOLA SAID THAT THERE HAS BEEN GENERAL SYMPATHY IN EC FOR EXTENDING MATURITY OF LOAN WHICH ITALY COULD ONLY REPAY WITH GREAT DIFFICULTY IN SEPTEMBER. HOWEVER, UK AUTHORITIES HAVE PROBLEM BECAUSE OF FACT THAT EC MEDIUM-TERM CREDITS ARE GOVERNMENT TO GOVERNMENT. THUS, CREDITS WOULD HAVE ADVERSE BUDGETARY AS WELL AS BALANCE OF PAYMENTS IMPACT. FRENCH, ALSO, ARE SAID TO PREFER TO WAIT UNTIL SEPTEMBER BEFORE TAKING ANY DECISION. OSSOLA THOUGHT THAT BECAUSE OF TIGHT TIMING, WAY MIGHT STILL BE FOUND TO EXTEND SHORT-TERM CREDIT FOR FURTHER PERIOD BASED ON "VOLUNTARY" PROPOSAL BY CREDITORS, RATHER THAN ON REQUEST FROM DEBTOR COUNTRY. VOLPE

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